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MONETIZATION OF THE CROSS LOC TRADE FOR THE SUSTAINABLE DEVELOPMENT OF KASHMIR REGION

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ABSTRACT

The issue of Kashmir has been the bone of contention between India and Pakistan for the last 60 plus years now. After the signing of Shimla agreement in 1972, the state of Kashmir was divided into two parts the Pakistan Occupied Kashmir (POK) on the Pakistani side and Jammu & Kashmir (J&K) on the Indian side. Since then the trade and travel routes between the two sides were closed. It was only after the cease fire agreement of 2003 that both the countries commenced the composite dialogue process. Though the initiation of cross LoC trade in 2008 was seen as a positive step in this process but it has its impediments also, the biggest one being that of settling transactions monetarily. This paper tries to identify the problem with the current barter model and the limited basket of commodities allowed for trade, and tries to address those problems with a proper monetary settlement mechanism.

KEYWORDS: Cross LoC trade, Barter trade, Monetization, Border irrelevance.

Introduction to Cross-LoC Trade

After the partition of India, the dispute over Kashmir territory remained unresolved between India and Pakistan which ultimately led to both countries fighting four wars. In the war of 1947 over Kashmir, a temporary cease fire line was setup which, after the Shimla Agreement, was renamed as the Line of Control(LoC). As a result of the war the Kashmiri territory was divided into two parts, Pakistan occupied Kashmir (POK) on the Pakistani side and Jammu & Kashmir (J&K) on the Indian side. Since then both the countries have been at odds with each other with relations worsening after the militia movement of 1990's. However on June 23, 1997 an agreement was reached between the foreign secretaries of both the countries on establishing joint working groups on outstanding issues with a separate working group on Kashmir. Since 2003 Pakistan and India have improved their relations and are cooperating with each other to chalk out a peaceful solution for the resolution of Kashmir by making border irrelevant without changing their earlier stand(Grono 2011).The foreign secretaries of the two countries met again in February 2004 to start the composite dialogue process, after assurance by General Pervez Musharraf that he won't allow terrorist attacks against India emanating from Pakistan.In 2005 the cross LoC bus service was started between Srinagar and Muzaffarabad followed by the opening of Poonch- Rawalakoteroute for travel on June 20, 2006 but it was restricted to divided families on both sides only. After the success of cross LoC bus service, Indian foreign minister, Pranab Mukherjee, went to Islamabad in May 2008 to initiate the process of cross LoC trade. Later in September 2008,the Indian Prime Minister, Dr.Manmohan Singh and Pakistani President Asif Ali Zardari held a high level meeting in New York in September 2008 in which it was agreed by both the leader that the Line of control should be opened for trade by October 2008 (Survey). and finally after six decades,on 21stOctober 2008, the line of control was thrown open for trade on two routes: Uri-Muzafarabad and Poonch- Rawalakote. The trade was agreed to be kept as Duty Free as the items to be traded between the two sides were treated as 'Goods Traded-in' and 'Goods Traded-out' and not as goods imported and exported. The items however were restricted to vegetables, fruits, dry fruits, saffron, rajmash, imli, carpets, gabas, shawls, namdas, foam mattresses, embroidery items,Kashmiri spices, rice, honey, maize, maize products, precious stones, tasbies, jaynamaz and medicinal herbs(Chowdhary 2010). Due to the duty free treatment of the traded commodities, traders trading through wagah border diverted some of the commodities via the LoC route which led to the banning of red chillies in March 2011 and onions in April 2014 by the POK authorities. The J&K authorities also restricted trade in garlic, lentils, ajwain, pistachio nuts and coconut (Sayem 2012).

Problems with barter

Settling transactions

The main problem with the cross-LoC trade is the absence of monetary mechanism to settle transactions. Money being a unit of account not only helps in smooth settlement but also increases the overall liquidity of the products. Traders spend hours negotiating in reaching a settlement over the relative price of their goods and this exercise continues after every successful settlement of the last trade.

Tax evasion

As the goods traded across LoC are based on barter transactions, the actual value of goods traded between the two regions cannot be ascertained but due to its Duty free treatment that isn't much of a worry for the government either. As the volumes of goods transacted across LoC increases, the state government may impose Duty on the trade to earn some revenues which is fair enough given the cost of security maintenance and infrastructure. But under the current barter model that isn't possible as the actual value of goods traded is not quoted in monetary terms.

Lower output

Since the trade is done on Barter terms, it is restricted to a few trading families and most of the producers are reluctant to trade through LoC as they not only find ready buyers within Kashmir but also are paid in money terms. While most of the goods allowed to be traded are of perishable nature, Those who do trade their produce find it frustrating, as they have to find buyers in their home markets for the goods they get in exchange and often they have to sacrifice a major share of their margin. Due to this reason the number of registered traders has fallen to 60 in 2014 as against 580 in 2008 and a mere 20 to 30 trucks cross over to the other side as opposed to 50 plus trucks crossing earlier (Noor, 2014).

Lack of credit

The traders trading their goods across LoC find it very hard to secure pre shipment credit and often times they are asked to offer some mortgage to secure a loan as opposed to this, the traders who trade goods through Jawahar tunnel find it very easy to secure credit.

Contract enforceability

Poor Contract enforceability is also one of the factors that are keeping the traders away. Traders on both sides have complained about their counter party not meeting their obligations.

Quality of products

Another problem with the current model is that of quality. As the traders trade goods for goods, traders complain of the poor quality of the items they receive in exchange. As Labelling and quality standards are hard to be achieved under Barter model, traders have to rely on mutual trust which often proves futile.

Perishability

Another problem that the traders face is the perishability of most commodities allowed for trade which forces the traders to accept the relative price at which the counter party

Concept of Border Irrelevance

With the advent of globalisation, international borders have been reduced to lines on the world map. Goods produced in one part of the world are sold in far distant markets seamlessly. While faster modes of transportation and advances in the field of technology contribute heavily but it is mostly due to global economic integration which has given a free market access to foreign enterprises. Almost all economies around the world are linked together due to labour migration, trade or investments. It is due to globalisation that the volume of global trade has increased significantly to $8 trillion in 2005, recording a twenty seven fold jump from the earlier estimate of $296 billion(WTO 2007). As of 2012, EU is the second largest investor in the world and it accounted for 15% of global trade in goods and 22.5% of global trade in services(Cousin and Duval 2014). This was made possible due to the greater integration of world economies and the gradual removal of Duties and non-tariff barriers. Trade in goods, within EU, has

increased to €2800 billion in 2011 as against only €800 billion in 1992(European Commission 2012). After the formation of European Union in Nov 1993, EU developed a Schengen area to eliminate border controls, which not only increased the tourist flow to Europe but also made it cheaper and easier for traders to trade goods and services within the union. NAFTA is another agreement signed by USA, Canada and Mexico in 1994 and it superseded the Canada-USA free trade agreement. Over these years NAFTA has become the world's largest free trade zone with a combined output of $17 trillion (NAFTA 2008). Not only has it strengthened the North American Economies, it has also created millions of jobs and provided businesses and consumers with better market access. Mercosur is another trade bloc in Latin American Continent which was established in 1991 to promote free trade in the region. As of 2010 the trade grew to $88 Billion between the member countries (George Silverman 2013).ASEAN, another trade bloc in south EastAsia was found in Bangkok in the year 1967 to create a free trade zone between member countries. The official charter, however, was adopted at the 13thASEAN summit and it came into force on 16th December 2008. In 2010, of the 73 million tourists recorded in ASEAN member states, 34 million were from other ASEAN countries (Anjaiah 2011).

Recently China and Pakistan have agreed to setup China-Pakistan Economic Corridor (CPEC), which will connect Kashgar in Xinjiang with Gwadar port in Pakistan. The corridor would not only enhance the economies of both countries but it will be a transit route connecting china with Middle East and the African continent. As the corridor passes through Kashmir on the Pakistan side, experts have opined that it would enhance the tourism potential of Gilgit-Baltistan and POK while creating thousands of new jobs. To take advantage of CPEC, thecross-LoC trade routes can be softened as Kashmir on this side is also rich in natural scenery having huge tourism potential. It would be worthwhile to mention here that since CPEC belongs to Silk Road Economic Belt, it has huge potential not only for the tourism Industry but also for traders of Jammu & Kashmir as a whole. As per estimates traders can save around 1400 crore rupees on freight if they are allowed to trade through Karachi port which is only 1800kms away from Kashmir as against the distance of 3000kms between Srinagar and Mumbai (Baba 2007). As the existing Cross-LoC trade model has proven to be non-sustainable, the solution is to make the existing trade routes as transit pointswhich on one hand would strengthen the economy of the two sides and on the other, provide a solution for peaceful resolution of the never ending dispute.

Benefits of monetization

Settling transactions

Under the current barter model traders renegotiate for hours on the relative prices of their goods before entering into a new contract but With the involvement of money not only does it become a lot easier for the traders to settle their transactions but also helps in price discovery of the goods and services. Moreover monetization helps in shaping the marketability of products and services by allowing people to pay and receive their value in monetary terms. Traders across the two sides have been pushing for a monetary mechanism to be adopted which would help them in making a profit.

Widen the market

At present the traders find it very difficult to sell their produce as they are paid in terms of other commodities. Money not only has ready takers but it also solves the problem of want coincidence, thereby not only increasing the liquidity of goods and services but also helping the traders in reaping optimum benefits. However monetization of cross-LoC trade won't be enough to sustain the economy of both sides unless it is made a transit hub. A proper monetary setup would not only allow traders, on both sides including India and Pakistan, access to the two Kashmirs but would also help in making cross-LoC a transit route for importing and exporting goods and services.

Lack of credit

In the current competitive business environment entrepreneurs take huge risks by enter into new markets and product lines in order to widen their customer base to stay profitable. While entering new markets and securing new orders, huge funds are required which can be borrowed from banks but under the current Barter trade banks are reluctant to lend. The absence of proper accounting data and a monetary mechanism makes it impossible for traders to secure credit. By replacing this barter model with a formal currency settlement system, it would become much easier for traders on both sides to secure credit from banks by simply pledging their letter of credit.

Contract enforceability

In the current barter system the risk of counter party not meeting obligations is very high and this risk can be minimised with the use of money through proper banking channels. A letter of credit can be drawn in favour of the sender of goods and after the successful delivery of goods to the buyer money can be remitted to the account of the seller by buyer's bank.

Employment – tourism

The number of unemployed youth in Jammu & Kashmir were recorded at 6 lakh in 2012(Hakhoo), while in POK the percentage of unemployed youth ranges from 25 to 50% of economically active population(Schaffer 2005). Monetization can address this problem by creating hundreds and thousands of new jobs especially in the tourism sector. The two sides being rich in natural scenery already attract a lot of tourists and with the softening of borders and a monetary settlement mechanism; the economy of the two sides would increase manifolds.

Efficient market

With the involvement of money, not only would the tradersfind ready buyers and seller, it would also reduce the cost of selling goods which would in turnincrease the efficiency of the cross LoC trade route.

Mechanism to be adopted

To overcome the deficiencies of the current Barter model, the involvement of a monetary settlement system is necessary for the sustainability and growth of the cross-LoC trade. The involvement of foreign exchange will improve the efficiency and liquidity of the traded commodities. Drabu (2014) is of the opinion that the mechanism to be adopted for settling foreign exchange transactions should not expose the transacting parties to foreign exchange fluctuations. So the possible solution would be to allow the Banks to maintain accounts with other banks in foreign countries to settle foreign exchange transactions, which are known as Nostro, Vostro and Loroa ccounts. The term 'Nostro' means 'Ours', 'Vostro' means 'yours' and 'Loro' means 'Theirs'. Nostro is our account of our money held by a foreign bank, Vostro is the complete opposite, and Loro means our account of their money held by a foreign bank. These accounts, used widely by banks to settle foreign transactions, can be used to monetize the cross-LoC trade. A bank from Jammu & Kashmir, say J&K Bank can open a 'Nostro' account in the Bank of POK while the same bank maintains a 'Vostro' account in J&K Bank.

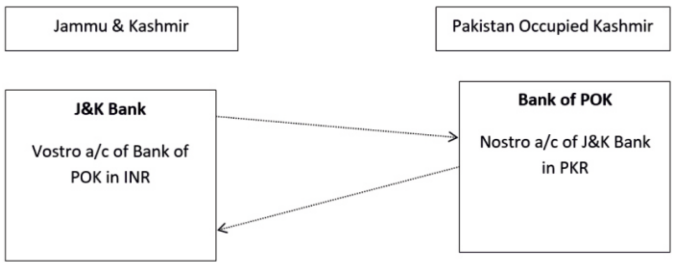

Figure: 1.1

This process is graphically illustrated in Figure 1.1 above. So basically it is a current account that J&K Bank will open with the Bank of Pakistan Occupied Kashmir and the Bank of Pakistan Occupied Kashmir will open the same in J&K Bank. These accounts are then used to settle foreign exchange transactions. For Instance, suppose a trader in POK wants to purchase goods from a trader in Jammu & Kashmir worth INR 1,00,000. He will simply deposit money in Pakistani Rupee (PKR) in the Bank of POK for the corresponding amount (INR 1,00,000) and a swift message will be sent to J&K Bank to make payment to the seller using their Nostro account. In the same manner J&K Bank will use their Nostro account in Bank of POK to transfer funds to suppliers of POK. A bank in Pakistan may also, under an agreement, refer the Nostro account of the Bank of POK to settle the foreign exchange transactions with J&K Bank and vice-versa.Such account is known as Loro account. So if other banks have some arrangements with the Bank of POK, they don't need to maintain separate accounts with the banks in Jammu & Kashmir, they can refer the Nostro account of Bank of POK to settle forex transactions.

With the introduction of a formal banking channel to settle foreign exchange transactions, it would become a lot easier for traders to look for buyers or suppliers of commodities, which would in turn help in broadening the scope of cross-LoC Trade. In International trade, the exporter of goods asks the buyer to draw a Letter of Credit on his name and the money is transferred to his account once he meets the requirements at his end. With the Monetization of trade, this facility can be made available to the cross-LoC traders as well. For instance a buyer of apples can ask the Bank of POK to draw a Letter of Credit in his favour. The bank of POK will check the credentials of the buyer and then send the L/C through a SWIFT message to the J&K Bank, asking it to transfer the amount approved to the supplier using their Nostro account. The J&K Bank will then inform the seller to furnish the required documents to get the payment. The seller will receive the payment once he furnishes the transport receipt along with the invoice, irrespective of the buyer making the payment to his bank or not. Those banks that don't have a Nostro account can use the Loro account facility to draw a letter of credit. With the advent of international debit and credit cards, tourists use these cards either to withdraw money or make a purchase in a foreign country. But due to higher cost of transactions tourists prefer to carry foreign currency notes which they exchange with their local bank. The possible solution for this would be to draw a Demand Draft favouring a person drawn on the correspondent bank. Once the person reaches the other side, he/she can present the draft to the correspondent bank and get an instant smart card in exchange for the amount mentioned in the Demand Draft. The correspondent bank will adjust the amount in the bank's Vostro account.

Suggestions

- To harness the true potential of the Cross-LoC trade, a formal monetary mechanism needs to be adopted which would eventually help to make the

trade efficient.

- The existing positive list of 21 items allowed for trade is too small and there is a need to implement a Negative list of commodities to make it sustainable.

- Taking a cue from the different trade corridors and partnerships between nations, and the potential which Kashmir possesses due to its geographical location, there is a need to make the Cross-LoC a transit point.

- Special tourism packages should be designed to boost the tourism Industry across the LoC. The process of obtaining travel permits should be reformed and made less cumber some. The potential of China-Pakistan Economic Corridor should be exploited to attract tourists which would prove beneficial in creating new employment opportunities in the region.

- Traders should be allowed to travel to the other side to assess the market potential. Frequent buyer/Seller meets should be coordinated to widen the scope of the market.

- To reduce the costs associated with the transportation of goods, there is need to increase the truck load capacity from the existing 1.5 Metric tonnes to 9 Metric tonnes.

- To avoid the manual inspection of goods due to security reasons, there is a need to implement full body X-Ray scanners which can get the work done with greater efficiency.

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